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No. _____

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In The

Supreme Court of the United States

PRIMEGUARD INSURANCE COMPANY, INC. (RRG) and 1SOURCEAUTOWARRANTY.COM, INC.,

Petitioners,

v.

JOHN GARAMENDI, INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA, THE CALIFORNIA DEPARTMENT OF INSURANCE, and JON A. TOMASHOFF,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI WITH APPENDIX

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QUESTION PRESENTED

Does the federal Product Liability Risk Retention Act of 1981, as amended by the Liability Risk Retention Act of 1986, preempt non-domiciliary State laws that "indirectly" regulate the operation of risk retention groups (RRGs) by excluding risk retention group members from doing business in those States premised on the State's disagreement with Congress' policy that financially responsible RRGs and their members should be exempt from State control, provided that the RRGs adequately protect the public against non-performance by a member?

CORPORATE DISCLOSURE STATEMENT

PRIMEGUARD INSURANCE COMPANY, INC. (RRG), is a risk retention group formed pursuant to the Federal Liability Risk Retention Act, 15 U.S.C. § 3901, *et seq*. There is no parent corporation and no publicly held company owns more than ten percent (10%) of its stock.

1SOURCEAUTOWARRANTY.COM, INC. d/b/a 1Source Auto Warranty is a wholly owned subsidiary of First Assured Warranty Corporation. No publicly held company owns more than ten (10%) of its stock.

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Petitioners PrimeGuard Insurance Company, Inc (RRG), ("PrimeGuard"), and 1SOURCEAUTOWARRANTY.COM, Inc, ("1Source") respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit, entered in the above-titled proceedings on October 22, 2004.

OPINIONS BELOW

1. The August 19, 2002 order of the United States District Court for the Northern District of California denying Petitioners' Motion for Partial Summary Judgment is unreported and reproduced at Appendix 5a.

2. The October 22, 2004 Per Curiam Opinion for the United States Court of Appeals for the Ninth Circuit affirming the District Court was unpublished, is unreported and reproduced at Appendix 1a.

JURISDICTION

A three judge panel of the United States Court of Appeals for the Ninth Circuit entered its ruling affirming the District Court's denial of Petitioners' Motion for Partial Summary Judgment which argued that the federal Liability Risk Retention Act (RRA) of 1986 preempted California's parochial exclusion of PrimeGuard's risk retention group[1] (RRG) member, 1Source. The District Court dismissed as immaterial PrimeGuard's spotless record of performance

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[1] The RRA allows businesses with similar liability risks to form insurance cooperatives called "risk retention groups" ("RRGs"). The RRA was intended to encourage the formation of RRGs by eliminating the multi-state regulation of these entities, vesting primary regulatory authority with the RRGs' domiciliary state and prohibiting non-domiciliary states from directly or indirectly regulating RRGs.

matched by 1Source's impressive record towards its customers.

An interlocutory appeal from the District Court's denial was effectuated under 28 U.S.C. § 1292(b). The United States Court of Appeals for the Ninth Circuit summarily affirmed without oral argument on October 22, 2004. Petitioners filed a Petition for Rehearing or Rehearing En Banc on November 5, 2004. The Ninth Circuit denied that Petition on January 28, 2005. Associate Justice Sandra Day O'Connor granted Petitioners a 30-day extension of time to file a Petition for a writ of certiorari on April 14, 2005. The jurisdiction of this Court to review the interlocutory order of the Court of Appeals affirming the District Court's denial pivoting on the federal Liability Risk Retention Act is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION AND STATUTE INVOLVED

1. Article VI of the United States Constitution provides that, "This Constitution, and the Laws of the United States which shall be made in pursuance thereof...shall be the supreme Law of the Land...."

2. 15 U.S.C. § 3902(a)(1) states:

> "[A] risk retention group is exempt from any State law, rule, regulation, or order to the extent that such law, rule, regulation, or order would...make unlawful, or regulate, directly or indirectly, the operation of a risk retention group except that the jurisdiction in which it is chartered may regulate the formation and operation of such a group...."

STATEMENT OF THE CASE

Petitioner 1Source is a member of co-Petitioner PrimeGuard, a RRG formed under the Liability Risk Retention Act, 15 U.S.C. § 3901, *et seq.*. PrimeGuard has been writing liability insurance for vehicle service agreements (VSAs) issued by its members since April 6, 1998, or more than seven years. [2]

1Source accounts for approximately 70% of PrimeGuard's business, meaning that the latter would be crippled without the former.[3] 1Source markets VSAs directly to automobile owners as the primary obligor.[4] It is a price leader, innovating a new way of selling VSAs by reliance on the Internet marvel that Joseph Schumpeter would have identified as an engine of economic progress, a "process of industrial mutation that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one."[5] PrimeGuard insures that the VSA promises made by 1Souce to its customers are fully honored. [6]

PrimeGuard is domiciled in Hawaii. Under the RRA, it answers to Hawaii's financial responsibility and

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[2] Declaration of Mark Storrer In Support of Motion for Preliminary Injunction (ER 22-26) (ER denotes references to the joint 9th Circuit extract of the record and page number)

[3] Id.

[4] www.1sourceautowarranty.com

[5] Schumpeter, Joseph, Capitalism, Socialism, and Democracy, pg. 83, (1942).

[6] PrimeGuard insures 1Source's contractual obligations against claims brought by automobile owners if 1Source fails to pay for covered repairs. 1Source is the insured party and the individual automobile owners are the third party beneficiaries of PrimeGuard's policy with 1Source.

sister insurance laws. The Act permits domiciliary as opposed to non-domiciliary States to regulate the formation and operation of RRGs, with specified exceptions. *See* 15 U.S.C. § 3902(a)(1). PrimeGuard's insurance record is spotless. Neither Hawaii nor any other State has questioned its ability to satisfy its VSA insurance obligations to 1Source or its other members, and thus fully protect the public against non-performance in paying for covered auto costs.

PrimeGuard registered in California as a RRG in March 1999 as required by the Act, 15 U.S.C. § 3902(d)(2), despite California's apparent hostility. Research was unable to identify a single RRG that had chosen California as its domiciliary State. In contrast to several other States, California denies captive insurers like PrimeGuard specially tailored regulation consistent with the RRA.[7] Moreover, California has recently saddled RRGs with a 60-day waiting period before doing business. [8] *See* California Insurance Code § 132. The RRA scheme Congress fashioned has not occasioned a "race to the bottom" by States to attract RRGs. For example, PrimeGuard chose Hawaii as its domiciliary State, which features 18 RRGs in aggregate, compared with sister jurisdictions like Vermont and South Carolina, which have attracted substantially more.[9] An A.M.Best insolvency study for the years 1987-2002 revealed a failure rate for licensed property/casualty insurers of 1.0%, virtually identical with the corresponding 1.1% for RRGs.[10]

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[7] The Risk Retention Reporter, May 2005, Volume 19, No. 5, pg. 7.

[8] The regulation seems contradictory to the RRA, 15 U.S.C. § 3902(a)(1)(D), which omits any suggestion of a waiting period.

[9] Insurance Information Institute, May 2005 press release. (http://www.iii.org/media/hottopics/insurance/test3/?table_sort_725540=4&printerfriendly=yes)

[10] The Risk Retention Reporter, October 2003, Vol. 17, No. 10, pg. 5.

The RRA does not embrace a "caveat emptor" philosophy. Congress scrupulously protected consumers. For example, RRGs and their members are accountable to State laws regarding "deceptive, false, or fraudulent acts or practices..." 15 U.S.C. § 3902(a)(1)(G). Congress also protected consumers against financially irresponsible RRGs and non-performance by members. RRGs must comply with non-discriminatory capital requirements of their domiciliary States. Id. at § 3902(a)(1). They must submit to examinations by State insurance commissioners in each State in which they do business. Id. at § 3902(a)(1)(E). A State insurance commissioner may obtain a federal court injunction against an RRG upon a finding that "such group is in hazardous financial condition." Id. at § 3906. And an RRG must comply with a lawful order in a delinquency proceeding commenced by the State insurance commissioner if there has been a finding of "financial impairment." Id. at § 3902(a)(1)(E) and (F).

California has never questioned PrimeGuard's financial condition, tacitly conceding that 1Source's California customers would be fully protected in the event 1Source defaulted on its VSA obligations.

California law uniquely treats VSAs as "automobile insurance," not as a service contract as is customary in all other sister jurisdictions. *See* California Insurance Code § 116(b). Accordingly, California requires issuers of VSAs like 1Source to qualify as authorized insurance companies on the same terms and conditions as industry giants such as Allstate, State Farm or Nationwide before they may advertise, sell, service, or adjust its auto warranty claims in the State. California apparently believes that only conventional insurance companies feature the capital and surplus necessary to protect consumers against non-performance, notwithstanding the RRA.

The California Department of Insurance formed a special squad to target Internet issuers of VSAs, including 1Source.[11] In contrast, California automobile dealers selling VSAs are not actively policed by the Department of Insurance. [12]

On or about August 29, 2001, the then Commissioner of Insurance, and predecessor to Respondent Garamendi[13], Harry Low, indirectly hobbled PrimeGuard's operations by issuing a Cease and Desist Order against 1Source's marketing of VSAs to California consumers. *See* Appendix 41a. In accord with California law, a subsequent hearing was held by an Administrative Law Judge (ALJ). The ALJ's recommendation to affirm the Cease and Desist Order on the theory that 1Source was selling automobile insurance in California without a certificate of authority to do so under § 116(b) of the California Insurance Code was accepted by the Commissioner of Insurance on March 21, 2002. *See* Appendix 46a. The Cease and Desist proceedings were initiated without any public complaints. [14] (Indeed, 1Source was saving its customers 20-50% off customary VSC rates[15]). The Denver Better Business Bureau reports a nationwide complaint rate against 1Source of three-tenths of one percent (0.3%).[16] Neither did California find that 1Source's

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[11] Transcript, Cross-Examination of Jon Tomashoff at California Department of Insurance hearing, December 7, 2001 (ER 54)

[12] Id.

[13] John Garamendi replaced Harry Low as Commissioner on January 6, 2003.

[14] One grievance against 1Source was later filed. *See* Defendants' Responses to the First Set of Requests for Documents.

[15] Transcript of May 9, 2002 hearing, page 20

[16] http://www.denverbbb.org/custom/search.cfm

marketing of VSAs was misleading, false, or deceptive in any way.

Before the ALJ's decision, Petitioners on February 12, 2002 filed suit in the United States District Court for the Northern District of California seeking a declaration, *inter alia*, that the Cease and Desist Order was preempted by the RRA. An injunction against enforcement of the Order was also requested. Constitutional equal protection and commerce clause claims supplemented the federal preemption argument. *See* Appendix 59a.

The District Court denied Petitioners' Motion for Partial Summary Judgment on the preemption claim. It reasoned that the RRA did not preempt application of California's insurance laws to 1Source, a PrimeGuard member. According to the District Court, a non-domiciliary State is unrestricted in regulating the business dealings of a RRG member with the public even if its practical impact indirectly impairs the RRGs operations. *See* Appendix 5a.

The District Court certified the federal preemption issue for interlocutory review under 28 U.S.C. § 1292(b) because, "It appears that no other court in the circuit, the 9th Circuit, has previously addressed [Petitioners'] position or that a similar-or the similar issue on point." *See* Appendix 4a.

The United States Court of Appeals accepted the certification and summarily affirmed without oral argument. It categorically declared that, "The Risk Retention Act does not exempt from regulation members of risk retention groups; rather, it exempts risk retention groups themselves." *See* Appendix 2a. In other words, the RRA placed absolutely no limits on State regulation of RRG members.

A petition for rehearing or rehearing en banc was denied. *See* Appendix, 24a.

REASONS FOR GRANTING THE WRIT

1. The Ninth Circuit violated this Court's "plain meaning" canon of statutory instruction in denying that State rules or orders crippling RRG members could effectuate an "indirect" regulation of the operation of a RRG[17]

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[17] The interlocutory nature of the decision below should not deter this Court from granting the petition. Interlocutory orders that either conflict with existing precedent or "produce immediate consequences" have been regularly reviewed. Mazurek v. Armstrong, 520 U.S. 968, 975 (1997). This Court has found it appropriate to review interlocutory rulings that are "fundamental to the further conduct of the case". *See e.g.* Larson v. Domestic and Foreign Commerce Corp., 337 U.S. 682, 685 n.3 (1949)(reviewing jurisdictional issue); Land v. Dollar, 330 U.S. 731, 734 (1947); U.S. v. General Motors Corp., 323 U.S. 373, 377 (1945)(reviewing interlocutory ruling that construed statutory language applicable to further proceedings); *see also* Michael v. U.S., 454 U.S. 950, 951 (1981)(White, J. dissenting from denial of certiorari)("[w]here there is an important and clean cut issue of law that is fundamental to the future conduct of the case and that otherwise would qualify as a basis for certiorari, interlocutory status need not preclude review.")

In this case, the Ninth Circuit's ruling that the RRA does not preempt indirect state regulation of the operation of RRGs by evicting their members dramatically impacts the further conduct of the case. A reversal of the Ninth Circuit's ruling would avoid the need to decide pending constitutional issues under the Commerce and Equal Protection clauses. Under these circumstances, it is appropriate for this Court to review the interlocutory decision addressing an important question of federal preemption. *See* Pharmaceutical Research and Manufacturers of America v. Walsh, 538 U.S. 644 (2003)(reviewing preliminary injunction to determine if lower court correctly decided issue of preemption under federal Medicaid law).

The order below also clearly produces "immediate consequences" for Petitioners and all other members of liability risk retention groups. Mazurek, 520 U.S. at 975. If the Cease and Desist Order entered remains in force, states may effectively destroy RRGs by

The Ninth Circuit held that neither PrimeGuard nor 1Source enjoyed protection under the RRA against California's eviction of 1Source because federal preemption does not reach RRG members, but only RRGs themselves: "The Risk Retention Act does not exempt from regulation members of risk retention groups; rather, it exempts risk retention groups themselves." *See* Appendix 2a. The Ninth Circuit ignored the plain meaning of the RRA, contrary to American Tobacco v. Patterson, 456 U.S. 63, 68 (1982), and Connecticut National Bank v. Germain, 503 U.S. 249, 253-254 (1992).

The Act prohibits non-domiciliary States from "indirectly" regulating the operations of RRGs. The ordinary meaning of "indirect" is "resulting otherwise than directly, as effects or consequences." *Wordnet 2.0* (2003). Accordingly, the operations of a RRG may be "indirectly" regulated or thwarted by State decrees that prohibit its members from doing business in those jurisdictions in violation of the RRA. The Ninth Circuit, however, turned the word "indirectly" into an ink blot as applied to State attacks on RRG members, contrary to the clear meaning of Congress.

In this case, California's order excluding 1Source from its VSA market indirectly withered the operations of PrimeGuard in the State by erecting a Chinese wall against its Ursa Major member. The barrier aimed at the RRG

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arbitrarily prohibiting their members from operating within their borders. In addition, nothing can be gained by requiring further proceedings before review is granted on a pure issue of preemption law. *See* Gillespie v. US Steel Corp., 379 U.S. 148, 153 (1964)(review of interlocutory order granted where "the costs... will certainly be less if we now pass on the questions presented here rather than send the case back with those issues undecided"). Rather, this is a case where "the right of appeal is of very little value to [the petitioner if] he may be ruined before he is permitted to avail himself of the right." Forgay v. Conrad, 47 U.S. (6 How.) 201, 205 (1848).

member was thus preempted under § 3902(a)(1). That conclusion is fortified by the unambiguous intent of Congress that preemption was to be muscular, not effete for RRGs: "[t]he authority of non-domiciliary states to license and regulate risk retention groups is largely preempted." State of Fla. v. Nat'l Amusement Purchasing Group, Inc., 905 F.2d 361, 363 (11th Cir. 1990).[18] Every court that has addressed the issue has stressed the breadth of RRA preemption. *See* Swanco Insurance Co. v. Hager, 879 F.2d 353, 357 (8th Cir. 1989), *cert. denied*, 493 U.S. 1057 (1990)("The authority of non-domiciliary states is largely preempted."); State of Florida Department of Insurance v. Nat'l Amusement Purchasing Group, 905 F.2d 361, 363 (11th Cir. 1990)(characterizing the Act as containing "sweeping preemption language"); City Cab Co. v. Edwards, 745 F. Supp. 757, 761 (D.Me. 1990)("The express preemption of state law with respect to risk retention groups is expansive..."); Nat'l Home Insurance Co. v. State Corporation Commission of the Commonwealth of Virginia, 838 F. Supp. 1104, 1109 (E.D.Va. 1993)("The preemptive thrust of the Risk Retention Act is pellucidly clear."); Garage Services and Equipment Dealers Liability Assoc. of America v. Homes, 867 F. Supp. 1301, 1304 (E.D.Ky. 1994)(remarking that the Act "broadly preempts" the states from regulating directly or indirectly the operation of a risk retention group).

The United States Court of Appeals for the Second Circuit, in contrast to the Ninth Circuit, sensibly gave independent meaning to the word "indirectly" in Preferred Physicians Mutual Risk Retention Group v. Pataki, 85 F.3d 913 (2nd Cir. 1996). In that case, New York encouraged

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[18] Unlike the provision in this case, the preemption provision relating to purchasing groups "took the opposite approach and avoided sweeping preemption language in favor of designated specific categories of state law to be preempted." The Insurance Co. of the State of Pa. v. Corcoran, 850 F.2d 88, 91 (2nd Cir. 1988); *see also* 15 U.S.C. § 3903.

medical practitioners to boycott RRGs by offering a free layer of excess insurance coverage only if their primary coverage was with a New York licensed insurer. The Second Circuit concluded that seeking to manipulate the insurance choices of practitioners against RRGs would constitute illegal indirect State regulation of the groups themselves if the manipulation substantially compromised their ability to compete with the favored in-state insurers. Id. at 917. That conclusion obtained even though the direct targets of New York's manipulation were not RRGs themselves. The Ninth Circuit's ruling would have automatically exonerated New York because its excess insurance law focused on RRG members.

The Ninth Circuit's interpretation makes a mockery of the RRA. Congress concluded that where, as here, a financially responsible RRG guaranteed performance of the obligations of its members to the public, non-domiciliary States were preempted from imposing additional requirements on those members to further insure that the obligations would be honored. The latter constitutes an "indirect" State regulation of the operation of the RRG itself by shrinking or evicting its membership group. By analogy, a State would be indirectly regulating wine producers by circumscribing eligible buyers. *See* Granholm v. Heald, 2005 WL 1130571 (May 16, 2005).

Certiorari is warranted to provide an authoritative interpretation of "indirect" State regulation of the operations of RRGs prohibited by the RRA under 15 U.S.C. § 3902(a)(1), especially because the economic ramifications of the issue are great and implacable State hostility towards preemption continues to generate dispute and litigation.

2. The Ninth Circuit decided an important question of federal preemption under the Risk Retention Act in a way that threatens the viability of risk retention groups by inviting crippling attacks on RRG members by state insurance commissioners tirelessly devoted to defending and expanding their regulatory turf

A. Risk Retention Groups Are Economically Significant

As of April 2005, 192 RRGs were operating in the United States, a jump of 10 from 182 in November 2004.[19] Premiums written by RRGs are projected to climb to $2.16 billion in 2004, an increase of 24.1% from $1.7 billion in 2003.[20] By 2001, the number of RRG insured members had soared to 174,000.[21] These figures understate the economic impact of the RRA. Competition in the business liability insurance sector is enhanced by the prospect that dissatisfied customers will form RRGs. In sum, the Ninth Circuit's decision leaving RRG members defenseless against hostile State regulation may confound the operations of the financially impressive RRG industry and thwart competition and consumer welfare, contrary to the intent of Congress.

B. State Insurance Commissioners Are Implacably Hostile to the RRA, RRGs, and their Members

From the birth of the idea of the RRA, state insurance commissioners have fiercely resisted congressional encroachment on their traditional bureaucratic turf

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[19] www.rrr.com/news

[20] The Risk Retention Reporter, October 2004, Volume 18, No. 10, pg. 1.

[21] www.rrr.com/education/growth.cfm

conferred by the McCarran-Ferguson Act (15 U.S.C. § 1011, *et seq.*). They have denied that the RRA was needed to promote affordability and availability of business liability insurance. They have insisted, contrary to demonstrable fact, that RRGs would be financially risky propositions dangerous to the public. They have given a cramped construction to the RRA, campaigned against its enlargement, and unleashed lawsuits against RRGs or their members. In sum, State insurance commissioners have rebelled against the congressional conclusion, enshrined by the RRA and substantiated by experience, that RRGs and their members need federal preemption to reduce liability insurance costs and expand liability insurance availability, both achievable without jeopardizing customary consumer safeguards against insolvency or fraud. The following chronicle speaks volumes.

During a 1977 congressional hearing, Mr. Lester Rawls, President of the National Association of Insurance Commissioners, testified that federal legislation would be gratuitous:

> The NAIC does not believe that the federal government should become involved with insurance availability plans in the products liability field at this time for at least two basic reasons. First, as the Federal Interagency Task Force on Product Liability noted in its "Briefing Report" earlier this year, the "unavailability" situation in the products liability insurance market is not so serious as to justify a federal reinsurance program like that contemplated in the bills enumerated above. Secondly, the NAIC believes that existing and proposed local industry placement committees are best-suited to handling whatever availability problems

> exist on the state level. Unless existing market conditions drastically change to undercut these two considerations, there is no justification for injecting a new massive and costly federal venture which is not aptly designed to solving the real problem.[22]

During a 1978 hearing, Wesley J. Kinder, the Insurance Commissioner of California and the Vice President and Chairman of the Executive Committee of NAIC co-authored a statement also insisting that federal legislation was unnecessary to override state regulatory burdens on risk retention groups:

> Another false premise underlying the PLRAA is the notion that "[s]tate insurance laws contain barriers to the formation of risk retention groups which are inappropriate and which, as a practical matter, preclude their formation." After examining the examples of state "regulatory burdens" cited by the Department of Commerce the NAIC cannot agree that state laws are serious impediments to the formation of product liability reciprocals, or "risk retention groups."[23]

NAIC adopted the following resolutions during its June 1979 meeting:

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[22] U.S. House of Representatives, Committee on Small Business, Subcommittee on Capital, Investment and Business Opportunities, Hearing on Product Liability Insurance, 95th Cong., 1st Sess., 1977 at 863 (emphasis added); see also p. 851.

[23] U.S. House of Representatives, Subcommittee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce, Hearing on Product Liability: Legislative Hearings, 96th Cong., 1st Sess., 1978 at 1006-1007.

> THEREFORE BE IT RESOLVED, that the NAIC opposes any proposal which places regulatory supervision over "risk retention groups" in the hands of the federal government, and
>
> BE IT FURTHER RESOLVED, that the NAIC opposes the "Product Liability Risk Retention Act of 1979" as explained by the U.S. Department of Commerce as an unwarranted and inadequate substitute for state regulation of product liability insurance[.][24]

Congress found the parochial and alarmist views of state insurance commissioners unpersuasive. It enacted the RRA in 1981, but confined it to product liability insurance. Congress anticipated State hostility, and thus fashioned a broad preemption provision. *See* 15 U.S.C. § 3902(a)(1). The House Report elaborated:

> In the last Congress, the Committee's Subcommittee on Consumer Protection and Finance held nine days of hearings on the products liability problem, three days of which were devoted exclusively to examining the nature and causes of the problem ... The Product Liability Risk Retention Act of 1981 evolved out of these hearings.
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> * * * * * * *

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[24] U.S. House of Representatives, Subcommittee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce, Hearing on Product Liability: Legislative Hearings, 96th Cong., 1st Sess., 1978 at 1005-1006 (emphasis added).

> The overwhelming majority of the witnesses, who appeared before the subcommittees, agreed that the rising costs of product liability insurance in the form of increased premium and higher deductibles, continue to place a severe economic burden upon product sellers, particularly small businesses.
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> * * * * * * *
>
> *Federal action is necessary because experience has shown that individual state legislation cannot facilitate the formation of self-insurance groups. Individual states can only enact legislation affecting their respective insurance law requirements. The practical effect of these laws is to prevent product sellers located in several states from forming such groups.*
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> * * * * * * *
>
> In product liability, because of the geographical dispersion of firms with similar risk interests, it is inevitable that more than one state jurisdiction becomes involved in insurance-oriented solutions. *Therefore, federal action must be taken.* [emphasis added][25]

The resentment of State commissioners over the RRA found expression in a Model Risk Retention Act drafted by the NAIC to circumscribe its application by a crabbed definition of "product liability." Accordingly, Congress amended the RRA in 1983 to clarify the meaning of the term and foil the State mischief. The accompanying Senate Report

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[25] H.R. Report No. 190, 97th Cong., 1st Sess.1433 - 1435 (1981), *reprinted in* 1981 USCCAN 1432 (emphasis added)("This preemption is central to the act's objective ....").

sharply warned States to accept the supremacy of federal law as written, and to eschew massive resistance:

> Following the enactment of the Risk Retention Act, the National Association of Insurance Commissioners (NAIC) proposed the adoption of a model State act to assist the States in implementing the Federal act. While this model bill may be a helpful piece of legislation on the whole, it departs from the language of the Risk Retention Act in a critical area and adopts a definition of "products liability" that restricts the scope of the Act.
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> * * * * * * *
>
> The Committee appreciates the concern of some State insurance regulators that the Risk Retention Act not be used as a vehicle to avoid legitimate State regulation .... *However, insurance regulators should not construe the law in a way that defeats the full purpose and objective of the Risk Retention Act.*[26]

Experience under the RRA proved rewarding. Accordingly, Congress expanded the law in 1986 to enable any business or any state or local government to obtain any type of business liability insurance from RRGs, and maintained the RRA's broad preemption hammer. The House Report amplified:

> The 1981 Act was premised on an 18-month study by the Federal Interagency Task Force on Product Liability. It was believed that the

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[26] Senate Report No. 172, 98th Cong., 1st Sess.2077 (1983), *reprinted in* 1983 USCCAN 2075 (emphasis added).

> proposed risk retention legislation would help deal with the fact that many rates appear to be based not on actuarial techniques, but on subjective underwriting judgments ..... It was also believed that the 1981 Act, by providing alternative[s] to traditional insurance, would promote greater competition among insurers to "encourage private insurers to set rates to reflect experience as accurately as possible." House Report 97-190 page 4.
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> * * * * * * *
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> *The Committee believes that these considerations remain valid and justify expansion of the scope of the 1981 Act to include other lines of liability insurance, as set forth in the current bill.*
>
> * * * * * * *
>
> In addition to noting the Committee's belief that the current bill is needed because it can help address the problems discussed above, it should be noted that the particular form of this legislation is required because of certain aspects of State law. *Some states have created capital and other requirements that make it difficult for risk retention groups to form or to operate on a multi-state basis.... It is necessary to exempt risk retention and purchasing groups from State law, in the respects specified in the Risk Retention Act, in order to achieve the beneficial effects of such groups referred to above.* [emphasis added][27]

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[27] H.R. No. 865, 99th Cong., 2nd Sess. 5304-5306 (1986), *reprinted in*, 1986 USCCAN 5303.

Congress recognized, however, that it was entering uncharted waters. It thus instructed the Secretary of Commerce to evaluate implementation of the RRA, including the regulatory structure and preemption provisions, and promised amendments would be forthcoming to cure any defects.

> ....Section 10 of the 1986 Amendments provides for an evaluation by the Secretary of Commerce, including an evaluation of the regulatory structure and preemption established by the Act and a report upon its adequacy. The Committee is reporting this bill [sic] that it creates a workable legal framework. At the same time, the novelty and complexity of implementation of this legislation require extra vigor in the exercise of the Committee's responsibility to follow up with oversight of implementation. The Committee believes that the current legislation is sound, but the Committee will not hesitate to return to the subject if the results are unsatisfactory.[28]

In response to comments invited by the Department of Commerce on March 17, 1987, state insurance commissioners uniformly assailed the RRA and its preemptive effect on state solvency standards and otherwise. The following submissions confirm their implacable hostility to the federal law:

> The NAIC remains extremely concerned about the ability of states to ensure financial integrity and to enforce various provisions of the RRA 1986. In addition, certain provisions

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[28] H.R. No. 865, 99th Cong., 2nd Sess. 5318 (1986), *reprinted in*, 1986 USCCAN 5303.

of the federal act are imprecise, but experience and future court interpretation may be the only feasible manner to clarify legal standards. [29]

...

Still another fundamental concern is that, by enacting RRA, Congress preempted not only insensitive state inaction and irresponsible state action, but also undermined and undercut thoughtful and responsible state action - including state action in New York and elsewhere that, we think, will prove more efficient in resolving the very availability and affordability problems that understandably concern Congress. [30]

...

Congress has done an effective job of preemption, but has established an ill-conceived scheme of regulation, where residual state regulatory abilities are hampered or cosmetic in nature, leaving a regulatory void that is not in the public interest.[31]

...

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[29] *Liability Risk Retention Act of 1986: Implementation Report of 1987,* Appendix E-1 at 5.

[30] *Id.* at Appendix E-7 at 9 (New York Superintendent of Insurance).

[31] *Id.,* (Exhibit A at 4)

> In our view, the regulatory structure established by the Act is unsatisfactory in that it preempts a state's ability to set rigorous solvency safeguards.[32]
>
> ...
>
> Clearly the intent of Congress in this regard needs to be more clearly delineated to avoid (1) allowing many insurance companies to escape otherwise applicable state regulations or (2) having certain insurance companies subjected to state requirements not intended by Congress.[33]

These angry views were reiterated by NAIC in comments on the RRA offered to the Department of Commerce in 1989:

> The structure of the Act must be judged by how uniformly and effectively it is applied without the necessity of court interpretation. The Act's lack of definition and specificity has created regulatory voids which the states have attempted to fill....
>
> * * * * * * *
>
> The "onerous" state rules allegedly preempted by the Risk Retention Act are rules that have been found necessary in the past one hundred and fifty (150) years of insurance regulation. The Act has resulted in a hazardous regulatory void that will

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[32] *Id.* at Appendix E-8 at 4 (New Jersey Commissioner of Insurance).

[33] *Id.* at Appendix E-10 (Kansas Commissioner of Insurance).

> ultimately prove detrimental by certain entities taking advantage of this uncertainty.[34]

NAIC remains adamantly opposed to the expansion of RRGs and further loss of their regulatory turf. As a Congressional Research Service Report for Congress recounted:

> At the September 2003 meeting, the NAIC was encouraged to adopt a draft resolution that would put the group on record as opposing the expansion of risk retention groups. Among the reasons cited in the resolution was the danger to consumers from a limitation on states' regulatory authority, the example of the National Warranty failure[35], and the absence of an availability problem in property insurance that has not been addressed by state-based solutions. No resolution has been adopted, but a working group to examine issues surrounding risk retention groups was created and it met at the December 2003 NAIC meeting.[36]

State insurance commissioners have exploited alleged ambiguities in the RRA to sue RRGs or their

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[34] *Liability Risk Retention Act of 1986: Implementation Operations of 1989*, Appendix E-4 at 3.

[35] The National Warranty reference misleads more than informs. The RRG was domiciled in the Cayman Islands, not in the United States. It was grandfathered as a RRG under the RRA despite its foreign domicile before 1985. *See* 15 U.S.C. § 3901(a)(4)(C)(ii). No company has been permitted to initiate operations as a RRG under the federal law like National Warranty for more than two decades.

[36] Baird Webel: *The Risk Retention Acts: Background and Issues*, CRS Report for Congress, January 12, 2004.

members and to deny preemption. Lower federal courts have repeatedly confronted the preemption question. *See* pages 8-9, *supra*.. This Court has declined previous opportunities to provide definitive interpretive standards. *See* Dillon v. Combs, 895 F.2d 1175 (7th Cir. (Ind.) 1990), *cert. denied,* 498 US 1023 (1991)(federal jurisdiction issue); Home Warranty Corp. v. Caldwell, 777 F.2d 1455 (11th Cir. (Ga.) 1985), *cert. denied,* 479 US 852 (1986)(preemption issue); Hudson Insurance Company v. American Electric Corporation, 748 F. Supp. 837 (M.D.Fla. 1990), *aff'd,* 957 F.2d 826 (11th Cir. 1992), *cert. denied,* 506 US 955 (1992)(federal jurisdiction issue); Mears Transportation Group v. State of Florida, 34 F.3d 1013 (11th Cir. (Fla.) 1994), *cert. denied,* 514 US 1109 (1995)(preemption issue); National Home Insurance Company v. Commonwealth of Virginia, 444 S.E.2d 711 (Va. 1994), *cert. denied,* 513 US 1083 (1995)(court of competent jurisdiction issue); National Warranty Insurance Company v. Greenfield, 24 F. Supp. 2d 1096 (D.Or. 1998), *aff'd,* 214 F.3d 1073 (9th Cir. 2000), *cert. denied,* 531 US 1104 (2001)(preemption issue); Swanco Insurance Co.-Arizona v. Hager, 879 F.2d 353 (8th Cir. 1989), *cert. denied,* 493 U.S. 1057 (1990)(preemption issue). That omission has enabled State insurance commissioners to shackle a federal law to which they have never been reconciled by repeated legal attacks on RRGs and their members. The ruling of the Ninth Circuit aggravates the problem by categorically denying RRGs protection against indirect state regulation of their operations effectuated by legal assaults on their members. [37]

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[37] California is special problem because its Insurance Commissioner is popularly elected, and thus attracts the politically ambitious. *See* California Insurance Code § 12900(a) and (b). The incumbent briefly ran for governor in 2003.

C. *Congress has rejected as unsound the reasons state insurance commissioners proffer for regulating RRGs through their members*

Congress created threefold safeguards against financially irresponsible RRGs in the RRA. First, a RRG must comply with the capital and surplus requirements of its domiciliary State. *See* 15 U.S.C. § 3902(a)(1). Second, a non-domiciliary State is empowered to obtain a federal court injunction against a RRG in financially hazardous condition. *See* 15 U.S.C. § 3906. Third, a non-domiciliary State may issue an order against a RRG in a delinquency proceeding if there has been a finding of financial impairment. *See* 15 U.S.C. § 3902(a)(1)(F). The latter two powers have seemingly remained dormant (with no reported case law), indicating that domiciliary jurisdictions over RRGs are demanding adequate financial thresholds.

These threefold federal protections against RRG insolvencies have proven thoroughly satisfactory. As previously stated, an A.M. Best insolvency study for the years 1987-2002 showed the rate for property/casualty carriers approximated 1.0%, virtually identical with the corresponding 1.1% figure for RRGs. In sum, the tired refrain of state insurance commissioners that RRGs should be handcuffed because their escape from non-domiciliary States' insurance floors makes them financially unsound is counterfactual. In any event, Congress repudiated that hypothesis in the RRA, and deplored multiple State capital and other requirements. To reiterate a portion of House Report 865:

> "Some states have created capital and other requirements that make it difficult for risk retention groups to form or to operate on a multi-state basis.... It is necessary to exempt risk retention and purchasing groups from State law, in the respects specified in the Risk

> Retention Act, in order to achieve the beneficial effects of such groups referred to above."[38]

The Ninth Circuit's decision permits States to shrivel the RRG industry that Congress aimed to nurture and flourish by second-guessing the RRA's financial responsibility safeguards. California was authorized to shut down 1Source, the centerpiece of PrimeGuard's operations, based on California's fear that 1Source's VSA customers would be inadequately protected against non-performance unless 1Source qualified as a California insurance company, including capital and surplus requirements. Congress, on the other hand, concluded that 1Source's customers would be adequately protected by a financially sound RRG, PrimeGuard, ready, willing, and able to honor all of the contractual VSA obligations of its members.

Certiorari is warranted in this case to halt the relentless assault by State insurance commissioners against the operations of RRGs through their members. The Ninth Circuit wrongly insisted that Congress intended only State laws directly targeting RRGs to be preempted, and thus erased the term "indirect" from the law in defiance of congressional intent.

CONCLUSION

For these various reasons, the petition for certiorari should be granted.

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[38] H.R. No. 865, 99th Cong., 2nd Sess. 5304-5306 (1986), *reprinted in*, 1986 USCCAN 5303.

Respectfully submitted,

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